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Supreme Court of the United States

October Term, 1937.

No. 55.

MARY DUKE BIDDLE,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Certiorari for Review of Decision of the United States Circuit Court of Appeals for the Second Circuit.

BRIEF SUBMITTED BY *AMICUS CURIAE.*

WILLIAM H. HOTCHKISS,
Amicus Curiae.

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Supreme Court of the United States

OCTOBER TERM, 1937.

MARY DUKE BIDDLE,
Petitioner,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.
No. 55.

ON CERTIORARI FOR REVIEW OF DECISION OF THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF SUBMITTED BY WILLIAM H. HOTCHKISS, *AMICUS CURIAE.*

This brief supports the position of the Government. I am counsel for the London and Lancashire Insurance Company, Ltd., and a considerable number of other British insurance companies transacting business through United States branches. All of these companies are interested in a test case brought by the London and Lancashire, decided favorably by the United States Board of Tax Appeals (34 B. T. A. 295) and now on review in the Second Circuit. The main question in such case, i. e., who pays the British income tax —the corporation or its shareholders—is before the Court in this case, and the Court's decision may be controlling upon the outcome of such test case.

Statement.

The facts and figures involved in this case, as well as the proceedings below, are fully set out in the principal briefs.

Tersely, Mrs. Biddle claims credit on tax and deduction from gross income of the alleged British tax "deducted" from dividends received by her from British corporations, which corporations (pursuant to the British Income Tax Act, 1918, and the applicable annual Finance Act) paid income tax on their profits to the British Crown before the declaration of such dividends, such claim being made pursuant to the provisions of §131(a)(1) and (b), as to credit, and §23(c)(2), as to deduction, both of the Revenue Act of 1928.

The Government asserts that, since these British taxes were not imposed upon or paid by the petitioner within the meaning of such sections of our Act, she is not entitled either to credit on tax or to deduction from gross income, but concedes she is subject to tax only on the dividends actually received by her.

The case below is reported in 86 Fed. (2d) 718 (C. C. A. 2d) and in the Board of Tax Appeals in 33 B. T. A. 127.

It is immaterial to this issue that the petitioner here had imposed upon her and paid a British *surtax* on her dividends. When this case was in the Board of Tax appeals the Commissioner stipulated that issue out, and has allowed the petitioner credit on tax for the surtax so paid pursuant to §4 *et seq.* of the British Income Tax Act of 1918.

The only tax here involved is the *normal* tax paid by British corporations.

Summary of Argument.

The petitioner, being an American citizen, is subject to tax and entitled to "credit" and "deduction" in determining her tax liability in accordance with American law. She claims "credit" and "deduction" because of taxes imposed and paid pursuant to British law. The operation of the

British law, reduced to simple terms, is shown in the following illustration:

X Company earns profit in a given year of..	£1000
When the assumed tax rate is 20%, X Company is charged with and pays a tax of..	200
Balance for distribution to shareholders.....	£ 800

It may now declare a dividend of £1000 less income tax, or a free-of-tax dividend of £800. In either event, X Company pays its shareholders £800 and, at the same time, furnishes a warrant showing the "notional gross" dividend to be £1000; the tax appropriate thereto to be £200, and the net dividend £800. Only one normal tax actually is paid to the British Crown, and that is the tax of £200 charged upon and paid by the corporation in respect of its profits.

It follows that the petitioner did not have imposed on her and did not pay any *normal* tax to the British Crown.

ARGUMENT.

I.

Our Law.

1. The American system of taxation is one of direct imposition on and payment by the object of the tax, individual or corporate.

Cf. §§11, 12 and 13 of the Revenue Act of 1928 and the corresponding sections of the other Acts.

2. Petitioner is an American citizen, subject to income tax and entitled to "credits" and "deductions" as determined by our law, i. e., the Revenue Act of 1928. She made her returns on the cash, not on the accrual, basis.

3. Section 131(a)(1) of the 1928 Act allows a credit on tax to an American citizen for any income tax "paid or accrued" to any foreign country, and subdivision (b) of this section provides a limitation of such credit dependent upon a ratio arrived at by comparing entire net income with income from sources without the United States.

4. Section 23(c)(2) allows a deduction for taxes "paid or accrued" in connection with income taxes imposed by the authority of any foreign country which are not allowed as a credit on tax under §131.

5. To entitle the shareholders of a British corporation to either "credit on tax" or "deduction" from gross income, it must appear that there was a tax imposed upon and paid by such shareholder under the British law.

6. The American system of income taxation does not recognize the doctrine of "ultimate burden."

Shearer v. *Comm'r,* 48 Fed. (2d) 552, 555 (C. C. A. 2d); *Peterson* v. *Comm'r,* 31 B. T. A. 172.

Like views have been expressed by the Board of Tax Appeals and the Commissioner; for instance, in 6 B. T. A. 240; 27 B. T. A. 1219; 32 B. T. A. 513; I. T. 2768, C. B. XIII-1, p. 54; I. T. 2783, C. B. XIII-1, p. 54; I. T. 2790, C. B. XIII-1, p. 56, and S. M. 3714, C. B. IV-2, p. 50, among many others.

Thus, in our concept the shareholders of British corporations, while "bearing the burden," do not "pay" the normal British tax.

II.

Their Law.

1. Irrespective of the asserted differing concepts behind the American system and the British system, the net result as to the normal tax under both systems is the same.

The British corporation pays a normal tax of £200. There is no further or additional normal tax imposed or paid in respect of the profits or in respect of the profits distributed as dividends.

This is accomplished under our law by allowing credits on net income or deductions from gross income of the dividends received. Cf. §23(c)(2) of the Revenue Act of 1928 and §234(a)(3) of prior Acts.

By allowing the "tax appropriate to" the dividend as a credit on tax, the British law accomplishes the same result; hence, does not impose or collect a normal tax on dividends.

Both laws, prior to the Revenue Act of 1936, recognized that a normal tax on dividends out of profits which have already suffered and borne normal tax smacks of double taxation.

The only difference in result comes when the British taxpayer is subject to surtax. Under the illustration given, *supra*, our system bases surtax liability on the dividend received—£800. The British system bases surtax liability on the "notional gross dividend"—£1000.

2. This latter distinction does not help the petitioner. Parliament, unlike our Congress, is not limited by a constitution in determining what is taxable income. That Parliament provides for a *surtax* liability on a "notional gross dividend" does not establish the imposition and payment of a *normal* tax allowable as a credit under our law. The old doctrine of co-partnery may be offered in explanation of this distinction, but, actually, under both systems, the corporation and its shareholders are separate entities.

Cf. *Hamilton* v. *Commrs.* (1931), 2 K. B. 495;
Neumann v. *Commrs.* (1933), 1 K. B. 728.

3. Under the British system the income tax of, say, £200, is imposed upon and paid by the corporation whether or not dividends are paid.

Cf. Rule 1 of the General Rules applicable to Schedules A, B, C, D and E, and §§237, 106 and 1 of the Income Tax Act, 1918.

4. Under the British system the shareholder is not liable to pay, and does not pay, a normal tax on dividends received from British corporations.

Commrs. v. *Blott,* 8 Tax Cases 101 (H. L. 1921);
Ritson v. *Phillips,* 9 Tax Cases 10;
Neumann v. *Commrs.,* 18 Tax Cases 332 (H. L. 1934).

5. The doctrine of the earlier British decisions that the corporation, in paying its tax of, say, £200, was the collector for the Crown and, therefore, the agent of its shareholders has been exploded in recent cases.

This was frankly admitted by the British expert whose testimony is relied upon by the petitioner.

While withholding at the source is and long has been a major concept of the British system, it no longer is the law of England in respect of dividends. There is no normal tax on dividends and therefore no withholding.

Earlier Cases:

Attorney-General v. *Ashton Gas Co., Ltd.,* (1904) 2 Ch. 621; (1904) 2 Ch. 626; and in H. L. (1906) A. C. 10;
Marion Brooke v. *Commrs.,* (1918) 1 K. B. 257;
Samuel v. *Commrs.,* (1918) 2 K. B. 553; 7 Tax Cases 277;
Purdie v. *Rex,* (1914) 3 K. B. 112; where, however, Judge Rowlatt clearly foreshadowed the later decisions beginning with that in the *Blott* case, saying: "There is strictly no income tax on dividends at all."

Later Cases, beginning in 1921—some of which already have been cited:

Commrs. v. *Blott,* (1921) 2 A. C. 171, 175-176, 201 (H. L. 1921);
Bradbury v. *English Sewing Cotton Co., Ltd.,* (1922) 2 K. B. 569;
Ritson v. *Phillips,* 9 Tax Cases 10;
Commrs. v. *Dalgety & Co.,* 15 Tax Cases 216;
Neumann v. *Commrs.,* 18 Tax Cases 332 (H. L. 1934).

Summarizing these cases, it is clear that now (and in 1929) under the income tax laws of England:

(a) the corporation, in paying the normal tax of, say, £200 on its profits, is not acting as agent for its shareholders;

(b) in "deducting" the tax of £200 "appropriate to the notional gross dividend" of £1000 and distributing £800 to its shareholders, the corporation is not deducting or withholding a tax within the meaning of our law, but is distributing its profits available for dividends after payment of its own corporate income tax liability;

(c) there is no recoupment to the corporation of the tax paid by it, for the reason that, in the event of recoupment, it would have £200 left; however, it earns profits of £1000, pays its tax to the British Crown of £200 and distributes £800 to its shareholders, and thus has nothing left and has recouped nothing;

(d) there is no normal tax on dividends either on the corporation declaring them or on the shareholder receiving them; and

(e) the corporation is the only taxpayer; the shareholder is not a taxpayer—unless, of course, subject to surtax.

And, with regard to the suggestion of Lord Justice Romer, at page 521 in *Hamilton* v. *Commrs.*, (1931) 2 K. B. 495, that, if the company should declare a dividend without deducting tax, the shareholder himself would be liable to tax in respect of the dividend received, it seems sufficient to refer to the comment of Judge Learned Hand in *Woolworth Co.* v. *United States, infra,* that this amounts merely to the shareholders becoming "sureties for the tax primarily imposed on the corporate personality." There is no such question here. The petitioner's British corporations paid their taxes before declaring their dividends.

6. The use of the words like "paid by deduction or otherwise," "tax appropriate to the dividend," and similar words in the sections of the British law and the rules applicable to the same, does not affect the conclusion here urged.

If the British corporation is the aggregate of its shareholders, such aggregate suffers many "deductions" before profits distributable in dividends are arrived at—such as salaries, interest, rents and expenses—one of these "deductions" being the British income tax.

Similarly, the tax so "deducted" is appropriate to the dividends.

These phrases in the sections of the British law are strange to our ears and reasoning, but necessary for the British concept (see opinion of Judge Learned Hand in the recent decision of *F. W. Woolworth Co.* v. *United States,* 91 Fed. [2d] 973). None of them amount to the imposition of a normal tax on the dividends of shareholders or to the "payment" of such a tax by shareholders.

Even the British expert in his colloquy with Smith, trial member of the Board of Tax Appeals, near the end of the first day's hearing, admitted that the tax "is paid by the company on its own behalf and not on behalf of its shareholders and not as the agent of its shareholders."

It is not enough, under our law, that, as testified by such expert: "The corporation is, as it were, acting as a collector," or that, under British law, the shareholder is (as stated by Judge Manton in his opinion in this case below, summarizing the expert's testimony, 86 Fed. [2d] 718, at p. 720, par. 3) "regarded as the income taxpayer." To succeed here, this petitioner must bring herself within the meaning of the plain words of our law and establish that the amount for which she claims "credit" and "deduction" was "imposed upon" and "paid" by her under British law.

8. The certificates furnished its shareholders by a British corporation paying a dividend do not evidence imposition upon or payment of tax by the recipient shareholders. An examination of these certificates in the record will establish that they merely certify that the income tax (£200) on the profits (£1000) of the corporation, of which profits the dividend forms a part, has been or will be paid by the corporation. In short, such certificates are not some evidence of a payment by the corporation on behalf of the shareholders, as assumed by Judge Buffington in *Elkins* v. *Commissioner,* 91 Fed. (3d) 534, at p. 537, par. (2). To the contrary, they certify that the corporation has paid or will pay its own tax (£200) on its profits (£1000). The purpose of the certificates as to "reliefs" and as to "surtax" is made clear by Judge McLellan in the *United Shoe Machinery Co.* case (13 Fed. Supp., p. 97); by Judge Manton in this case below (p. 720), and emphatically by Judge Hand in the *Woolworth* case, *supra* (pp. 974-975).

9. Under the British system, the payment made by the corporation of its income tax on its profits is not a constructive payment for the shareholders.

This follows necessarily from the conceded fact that, under British law, the shareholder is not a taxpayer of normal tax. The case mentioned by Judge Buffington in the *Elkins* case, *supra* (*Old Colony Trust Co.* v. *Com-*

missioner, 279 U. S. 716) is not in point—the constructive payment in that case being for one who was a taxpayer.

10. The rulings of the Commissioner relied upon by the petitioner below and here, even if a proper interpretation of the British law at the time they were made, were clearly erroneous as that law has been determined since.

See "Earlier Cases" and "Later Cases," pp. 7 and 8, *supra.*

Faced with a serious dilemma, in that, if he revoked his rulings after his error seemed patent, the Commissioner, who knew that the instant case was on its way to this Court, could properly do no more than he did, that is, await the ultimate decision. A ruling by an administrative officer is not necessarily incorporated into the law by re-enactment of the provisions interpreted, particularly when—as in this case—such ruling is based upon an interpretation of a foreign law.

11. Analysis of the reasons given by Judges Buffington and Morton in the *Elkins* case (3rd Cir.) and the *United Shoe Machinery Co.* case (1st Cir.) will, it is urged, satisfy the Court that those judges did not grasp fully the concept of the British income tax system. This is notably so of Judge Buffington, who bases his conclusion on several factors [see p. 537, pars. (1), (2), (3), (4), (5) and (6)]. He overlooks (1) that as to dividends it now is settled that there is no collection of the tax at the source as in the case of rent and annual interest; (2) that the form of the warrants given shareholders does not in any way evidence that the corporation paid its tax on behalf of the shareholders; (3) that Parliament, in exacting a surtax on the "notional gross dividend," did definitely use as part of the base the tax paid by the corporation (compare treatment of tax-free dividend); (4) that preference dividends received on shares bearing a fixed rate are treated as is interest; (5) that the words "has paid any tax by deduction or otherwise" or "has been charged with tax by deduction or otherwise" are not used in connec-

tion with any provisions of the British statutes applicable to dividends and do not prove or establish the "payment" or the "charge"; and (6) that Parliament, just as it was free to lay surtax on the "notional gross dividend," was free to permit relief and rebate of the tax appropriate to the dividends to taxpayers exempt from tax. Judge Morton seems to fall into similar errors—in particular is he wrong in stating that, in the *Biddle* case, Judge Manton held that "the tax was a tax on the shareholders." The holding was to the contrary.

On this phase, may I not again refer to the enlightening decision of Judge Hand in the *Woolworth Co.* case, *supra.*

III.

Both Laws.

The nub of this controversy lies in the answer to the question:

> *Upon whom is the British income tax charged and by whom is it paid?*

There is nothing in this record establishing an imposition or a "charge to tax" at the normal or standard rate on the shareholder of a British corporation because of that shareholder's receipt of dividends from such corporation.

Nor is there anything establishing that such a shareholder pays such a normal tax to the Crown, in the sense of the word "paid" as used in our §§23 and 131.

Per contra, the record—spite the locution, frequently side-stepping (though from his concept sometimes apposite), of the British expert, and—if I may so say—the erroneous views of the British judges in their earlier decisions—makes plain that it is the corporation on which the "tax is charged" and by which it is "paid."

The decisions of our courts are uniform thus far in holding that the British corporations pay the tax:

Welch, Collector v. *St. Helens Petroleum Co., Ltd.*, 78 Fed. (9th) 631 (C. C. A. 9th);

United Shoe Machinery Co. v. *White, Collector*, 13 Fed. Supp. 97 (Dist. Ct. of Mass.);

United Shoe Machinery Co. v. *White, Collector*, 89 Fed. (1st) 363 (C. C. A. 1st);

Biddle v. *Commr.*, the instant case (C. C. A. 2d);

Woolworth Co. v. *United States*, 15 Fed. Supp. 679 (Dist. Ct.; So. Dist. of N. Y.);

Elkins v. *Commr.*, 91 Fed. (3d) 534 (C. C. A. 3d);

Woolworth Co. v. *United States*, 91 Fed. (2d) 973 (C. C. A. 2d).

IV.

Conclusion.

The petitioner having failed, by the evidence of her expert, the cited cases in the British courts and the provisions of the British income tax law and rules, to establish the imposition upon her or the payment by her of a normal tax "at the standard rate" on the dividends received by her from certain British corporations, she has not met the simple test of our law as found in §§131 and 23 of the Revenue Act of 1928.

With apologies to the Court for repetitions and reiterations concerning what seems to the undersigned a very simple question—a question with which he has been familiar since shortly after the coming down of the Blott decision in 1921—but which has been much befogged by testimony of the British expert and the many briefs submitted to numerous courts—the undersigned submits this brief in the hope that it may pierce the fog and that the decision here will be with the Government.

WILLIAM H. HOTCHKISS,
Amicus Curiae.